



JANUARY 1950

# BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

# Consumer Spending Continues Heavy

## A Sustaining Factor in Seventh District Business

Declining only slightly from the record levels of 1948, consumer spending during 1949 was one of the major supporting factors contributing to continued high levels of business activity. Consumer purchases of both durable and nondurable goods through the first three quarters in the Seventh District receded to levels not more than three per cent below the comparable period of 1948 in terms of dollars. Because of small but widespread price declines, physical volume sales exceeded 1948 in many lines. Preliminary reports indicate that October and November sales continued relatively weaker than those of 1948, but that December Christmas sales about equaled those of the previous year. Therefore, dollar sales for all of 1949 were probably somewhat below those of 1948 but substantially higher than 1947 volume.

It appears that the small decline in consumer expenditures witnessed last year was not caused by a proportional weakening in aggregate personal incomes. Despite a fairly substantial summer slump in production, employment, and average hours worked, Seventh District income continued at a level approximating that of the first three quarters of 1948, due primarily to the more-or-less general wage increases granted during the summer and fall months of that year. Most of the decline in sales appears to have resulted from satisfaction of the most urgent postwar needs for goods and services. Increased buying caution on the part of consumers also contributed to the decline.

Reflecting the continued high level of income and the slackening in demand for goods, total holdings of liquid assets by the public in the Seventh District continued to increase during 1949, and at a rate markedly higher than during 1948. The rate of new saving (through bank savings deposits, United States savings bonds, life insurance payments, and savings and loan association share accounts) during the second and third quarters of the year dropped more than seasonally from that of the first quarter, reflecting in part the summer slump in business activity. Nevertheless, it continued at a level substantially higher than that experienced during the comparable months of 1948. While liquid savings of consumers increased more than in 1948, net personal savings in the form of unincorporated business investment declined from the previous year's levels. The net result, nationally, was that personal savings of all kinds totaled only about 12 per cent more in 1949 than in 1948.

During the coming months the level of consumer expenditures, particularly for durable goods, is likely to become a crucial factor determining the general level of economic activity. Even though a decline in business expenditures for plant and equipment occurs, continued consumer spending at or above the relatively high level experienced during the past year could do much to main-

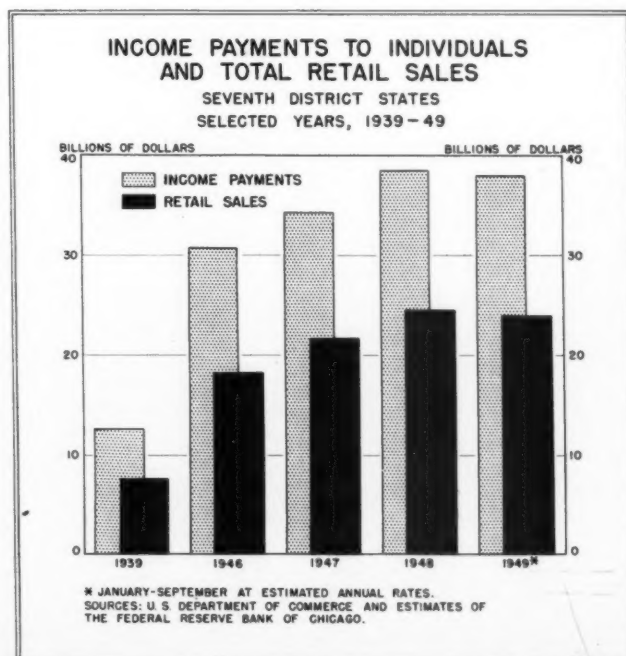
tain 1950 business activity. Conversely, the effects on business activity of a definite slide-off in consumer spending are not likely to be offset by increases elsewhere. Thus, the prospects for business during 1950 depend heavily on the prospects for consumer spending.

Major factors tending to support consumer spending are: (1) the temporary boost which will be given to personal incomes by the payment of the 2.8 billion dollar National Service Life Insurance dividend, 2.2 billion dollars of which will be paid during the first half of 1950; (2) the tremendous stocks of liquid and semiliquid savings in the hands of consumers; (3) the prospects for more aggressive merchandising in many lines, featuring especially better quality-price relationships, bargain sales, and improved service; and (4) maintenance of wage and salary payments at relatively high levels.

Major factors which may exert a downward influence on consumer spending are: (1) a possible increase in buying caution, occasioned by expectations of reduced earnings or further price cuts, such as occurred during the early part of 1949; (2) immediate satisfaction of nearly all of the backlogged demand of consumers; and (3) the likelihood of further moderate declines in some income receipts, particularly for farmers and proprietors of small businesses.

It seems likely, on balance, that the effects of the GI insurance dividend will maintain, or even increase, consumer spending during the months immediately ahead.

(Continued on Page Eight)





# The Midwest Stock Exchange

## *Neighboring Cities Join Chicago in Creating New Mart*

The Midwest Stock Exchange (MSE), an amalgamation of four regional exchanges, began operations in Chicago December 1, 1949. Brokers in Chicago, St. Louis, Cleveland, and Minneapolis-St. Paul have joined forces with the purpose of creating a mechanism for stock trading which will (1) provide a better market for publicly held stocks in the area served and, (2) reduce costs, since overhead expenses will be spread over a larger number of transactions.

The new exchange was favored during its first month of operations by heightened investor interest in common stocks. Volume on all exchanges during December was high as stock prices rose and the Dow-Jones industrial average broke through the 200 mark for the first time since 1946. The showing of the MSE was highly creditable relative to other markets. The number of shares traded on the MSE during December was about one-third greater than the combined total for the consolidated exchanges in the corresponding month of 1948, while volume on the New York Stock Exchange rose only eleven per cent. Volume on the MSE averaged over 50,000 shares a day, more than twice the daily average for the Chicago exchange during the earlier part of the year.

All trading is done on the floor of the old Chicago Stock Exchange (CSE) which will serve as the headquarters for the new exchange. Branch offices in St. Louis and Cleveland are linked to the headquarters by duplex teletype wires. Offices of members in other cities maintain contact with the new exchange through public teletype channels.

Some measure of success for the objectives of the merger is assured by the fact of consolidation itself, but long-range progress will depend upon acceptance by brokers and investing public of the new exchange as a strong regional market for those issues not suited to the national market by reason of size or extent of investor interest. Chicago is the nominal capital of the north central region, industrial heart of America. Ownership of much of the nation's industry is concentrated in this area, and supporters of the Midwest Exchange maintain that the principal Midwestern cities, working together, can support a stock market worthy of the wealth and productivity of the region.

A strong market for local and regional stocks would benefit a variety of groups. Stockholders would gain greater liquidity and higher collateral value for their investments, corporations would find financing easier, and brokers would increase their earnings.

Does the Midwest Stock Exchange provide the answer? Aggregate volume on the consolidated exchanges was running less than three per cent of the New York Stock Exchange (NYSE) totals. However, it is believed

that the new exchange is established on such a solid base that future growth will show the consolidation to be greater than the sum of its parts. Volume in the early weeks of operation justifies these expectations to the extent that transactions have been somewhat more than three per cent of the totals for the NYSE.

The new exchange is expected to grow through new listings of stock, new memberships in cities of the region, and heightened investor interest in listed issues. Over 400 issues are now available on the Midwest Stock Exchange. Three hundred of these were traded on the CSE; the rest were transferred from the other consolidating exchanges or were previously unlisted. Some increased trading activity may be expected because member brokers will be handling a larger number of stocks than previously. The effect is similar to a more complete inventory for a shopkeeper. Additional listings can be obtained by attracting suitable issues from the over-the-counter markets or encouraging public distribution of issues now closely held by a few owners. However, new listings and increased activity for issues already listed are not the final solution to the problem. Corporation executives must continually be resold on the advantages of having their securities listed on the Midwest Exchange, lest they shift these issues to the New York markets.

Another selling job needed for eventual success of the Midwest Stock Exchange is the encouragement of new memberships. This campaign received a setback when the Detroit and Cincinnati exchanges voted to stay clear of the merger. These decisions may be reconsidered if the new venture appears promising. However, individual firms, at least those which do not possess seats on the New York Stock Exchange, may well find it to their advantage to join regardless of the action of their local exchanges. Along with other advantages they will be able to earn full commission on the "dual issues" (also listed in New York) available on the Midwest Exchange.

Broker interest in membership was demonstrated during December by the rapidity with which an additional 42 memberships offered by the governors of the MSE were taken up. Several Cincinnati and Detroit firms have joined the MSE since the stock exchanges in those cities rejected consolidation. Membership includes firms headquartered in 50 cities from coast-to-coast with branch offices in over 300 localities.

At present all of the 400 authorized memberships have been sold. However, it is likely that the price of a seat on the MSE will not rise much above the \$2500 subscription price since the management of the MSE desires membership to be as widespread as possible and more seats may be authorized in the future. Aside from offering for sale the surplus seats available after the members of consolidating exchanges had transferred to the new exchange,

MSE officials have encouraged the transfer of dormant memberships to firms which will utilize them actively.

#### DECLINE OF THE REGIONAL EXCHANGES

Brokers everywhere have been greatly concerned over the low levels of stock trading prevailing in recent years. This decline since the twenties and middle thirties has hit the regional exchanges more severely, relatively, than the New York Stock Exchange. In 1929, share volume on the Chicago Exchange was over seven per cent of that on the NYSE; in the mid-thirties this proportion had dropped to less than four per cent; and in the past two years, it has been less than three per cent. In recent years a volume of 30,000 shares has been considered a good day on the Chicago Stock Exchange in contrast to 100,000 share days in the thirties. On the peak day in 1929 1,200,000 shares changed hands.

The experience of the Chicago Exchange has been duplicated elsewhere in the country. Many of the minor exchanges have closed down. In 1930 there were 35 to 40 regional exchanges. Prior to the MSE consolidation, that number had declined to 23, five of which were so small as to be exempted from SEC regulation.

The chief cause for the doldrums in the regional stock markets, aside from the factors depressing stock trading everywhere, has been the scarcity of new stock issues. In the twenties activity on the Chicago Exchange was stimulated by the large numbers of new issues of common stock by local firms. Sometimes these issues were immediately listed on the Chicago Exchange in order to clear the "blue sky" regulatory laws of a number of states. Some of the issuing corporations ultimately failed, and many successful firms sought listing for their issues on the New York exchanges as soon as it could be arranged.

The regional exchanges also have been hurt by unfortunate experiences of investors with the securities of relatively unknown companies. The result has been an even greater relative market interest in "blue chips" (usually listed in New York) than had formerly been the case. Moreover, the Securities and Exchange Act, which requires financial information and other data from firms whose securities are listed on regulated exchanges, probably has caused some issues which would be suitable for the regional exchanges to be traded over-the-counter, i.e., outside the organized exchanges.

#### DEVELOPMENT OF THE MERGER PLAN

Officials of the CSE have believed for years that the solution to the problems of the regional exchanges in the central states lay in consolidation through a teletype link-up. James Day, former president of the CSE and now president of the MSE, along with other interested parties, laid the ground work for the proposed merger through personal interviews in the cities concerned. The response was generally favorable, and the first conferences were held a year ago last fall.

By the time the membership of the Midwestern exchanges voted on the question of the merger, the Phila-

delphia and Baltimore exchanges had been operating on a combined basis for six months with apparent success. The motives for this merger were similar to those for forming the MSE, to establish a more concentrated market and reduce overhead costs. However, the proximity of Philadelphia to Manhattan obviates the concept of a vital regional market wedded to the economic life of the area concerned.

The Midwest merger agreement became effective last September 15. Companies listed on the exchanges included in the agreement were given 60 days to transfer to the MSE without charge. Members of the merged exchanges could join the MSE during this period on a straight \$2,500 payment.

#### ORGANIZATIONAL SETUP

In essence, the merger is based upon an agreement on the part of the Chicago Exchange to take a new name and admit to its ranks the membership of the other consolidating exchanges which agreed to liquidate. Three hundred of the Midwest's first 400 listings had been on the Chicago Stock Exchange, and 300 of the first 358 memberships went to former members of the Chicago Exchange. The president and chairman of the Midwest Exchange had held those positions with the Chicago Stock Exchange.

An attempt to avoid fears of domination of the new Midwest Stock Exchange from Chicago was made through the method of selection of the board of governors. In addition to the chairman and vice chairman (only one of whom will be from Chicago) there are 18 governors, nine from Chicago and three from each of the other exchanges.

Quarters of the St. Louis and Cleveland exchanges have been retained as board rooms for receiving and sending communications to Chicago concerning quotations, buy and sell orders, and financial information over special teletype circuits. Should Detroit and Cincinnati favorably reconsider their decisions to stay out, those cities doubtless would be included in the wire network. Brokers in other cities throughout the country will use the regular wire channels of member firms and public teletype to transmit orders to the floor of the exchange.

The new system is building upon the "clearing by mail" plan which has been successfully used by the CSE for about two years. "Clearing by mail" allows out-of-town members to trade through hired floor brokers instead of having to split commissions with La Salle Street firms. The floor broker receives the order by teletype, executes it, and sends confirmation by wire. The certificates are delivered by mail by the nonprofit Chicago Stock Clearing Corporation (a subsidiary of the MSE). Up to the time of the merger this plan was used by about 20 members within the range of overnight mail, as far away as Kansas City. Under the new setup a member of the MSE anywhere in the United States may make use of this facility.

The arrangement is similar to the operations of large brokerage houses with branches scattered throughout the country. Branch offices teletype their orders to New York where the transaction is often put into the hands of a



hired broker. However, under the MSE plan members need not have an office in the vicinity of the exchange itself.

Only listed stocks are traded except for some dual issues listed in New York which have unlisted trading privileges. Members will be allowed to trade certain issues of limited marketability "off-the-exchange" to help meet over-the-counter competition. The round-lot is 50 shares for most issues as had been the case with the Chicago Exchange.

#### SIGNIFICANCE OF THE NEW EXCHANGE

What is the place of the MSE in the national capital market? A study of the stock exchanges and over-the-counter markets convinced CSE officials that analysis of individual issues is necessary to determine whether they should be traded at New York, on a regional exchange, or over-the-counter. The main determinants are the size of an issue, its price, the geographical distribution of the holders, and, most important, the number of shares in the hands of the public, i.e., not closely held by a few individuals. Officials of the MSE believe that an issue of less than one million shares, with holders concentrated in the central states would have a better market on the Midwest Exchange than in New York.

Many stocks nurtured from infancy in Chicago during the past quarter-century have been transferred to the New York Stock Exchange or the Curb after a period of "seasoning." Some of these issues belonged in the national market in New York, but too often they suffered from transplanting. Midwest dealers may have been willing to make markets for stocks in which there was substantial local interest, but when the issues were moved to New York local dealers were apt to lose interest. The issue became "a little fish in a big pool." If trading in the stock continued at Chicago, activity was split, making for a poorer market all around. If corporations can be restrained from premature transfer of their securities to New York, an important requisite for success of the MSE will have been achieved.

No attempt will be made to bring issues back from Wall Street, but a vigorous campaign to obtain new listings will be pushed by the management of the new exchange. However, it is desirable that these issues be fairly well-distributed, since it is believed by MSE officials that adequate marketability cannot be assured unless 150,000 shares of an issue held by at least 700 owners are outstanding. Nevertheless, companies which wish to list securities for reasons of prestige or to establish a record of transactions will not be discouraged. The cost is \$1,000. About 50 corporations whose shares are now traded over-the-counter could list on the MSE advantageously according to a study in the hands of officials.

Securities now traded over-the-counter provide one source of new listings. Having securities listed is an aid to corporation-stockholder relations, and increases the investor appeal of an issue. A price set in the public market place assigns more definite value to stocks, and is reassuring to potential creditors. Furthermore, there is

a discipline involved in satisfying the rules and regulations of the stock exchanges and the SEC.

There is also a possibility of encouraging public distribution of the shares of corporations now closely held. If owners are willing to sell a portion of their holdings the benefits of listing are available to them as stockholders, and they may find that desirable publicity for the firm is gained through public distribution. Owners of stock in a closely held corporation may also wish a market value for their stock to simplify valuation for estate or inheritance tax purposes.

While very small issues (less than 100,000 shares outstanding) are usually considered to be best adapted to over-the-counter trading, investors are justly apprehensive of the wide spread between bid and asked prices quoted by dealers. This price uncertainty involved in over-the-counter operations probably cuts activity in these stocks.

It is possible that passage of the Frear bill which would extend SEC regulation to all companies which possess three million dollars in assets and have 300 or more stockholders would remove an important deterrent to listing.

#### FINANCING OF SPECIALISTS

A commonly heard complaint about the Chicago Stock Exchange has been that the specialists, those dealers who stand ready to buy and sell particular stocks, do not have the necessary capital to take a strong position in shares traded on the exchange. Traders are annoyed when bids disappear upon the offering of sizable blocks of stock.

This same complaint will doubtless be voiced against the Midwest Exchange, but often it will result from an improper evaluation of the place of the regional exchange. The function of a regional exchange should be to provide as good a market as possible for regional issues, and to facilitate trading in national issues which have their primary market in New York.

The charge of inadequate dealer financing is not valid when the nature of most local issues is taken into account. Sometimes the total stock outstanding of a small firm is only one or two hundred thousand shares and much of this may be closely held. Locating a buyer or seller for a sizable number of shares at a particular day or hour is apt to be largely a matter of chance. In the case of dually listed stocks the regional exchange should not be expected to absorb very large orders. Such transactions belong in New York.

The real problem is not the financing of specialists who may have no outlet for new purchases, but a sufficient flow of orders to buy or sell which is needed to maintain a market. Actually, up to 90 per cent of the transactions in a particular stock during a day's trading on the Chicago Stock Exchange in recent years were dealer financed as compared with an approximate 10 to 12 per cent for most active stocks on the New York Stock Exchange.

Nevertheless, a continuous market is practically impossible even in the most popular stocks without special-

ists to fill gaps in trading. Sponsors of the new exchange are well-aware of the problem. The clearing-by-mail arrangement should encourage out-of-town dealers to take a position in stocks which are of special interest to their particular locality. Corporate membership, permitted by the MSE but not, at present, allowed by the NYSE, allow incorporated underwriting houses to follow specific issues.

#### DUAL TRADING

One-half to two-thirds of the trading volume on the CSE in recent years has been in dual issues which are also traded on the NYSE, and the experience of the MSE is likely to be similar. Since these prices are usually set by the last trade in New York, some individuals are inclined to belittle this aspect of regional exchange activity.

Proponents of dual trading believe that stockholders should have the right to deal with their local brokers who may not be members of the NYSE. Keeping the entire transaction within the area means a saving of time and money. It is also maintained that so long as the spread between the bid and asked price on a stock in New York is at the minimum of one-eighth of a point no dilution is possible.

The principal objection to dual trading is that it dilutes the national market. A substantial number of the stockholders of every widely distributed national issue reside in the region embraced by the MSE. If all of these stockholders used the mechanism of the new exchange to trade the issues involved the result must be dilution. The whole idea of a stock exchange as a market place where buy and sell orders are concentrated is threatened if dual trading were carried to its logical extreme. It might even be argued that if stock transactions negotiated close to home are beneficial the consolidation of regional exchanges is unwise. However, officials of the MSE believe large and well-distributed issues may benefit from dual listing because of greater interest in the issue.

Of the 400 odd issues now available for trading on the MSE, over 200 are listed in New York. All but 68 of these dual issues had been traded on the CSE; the rest at St. Louis or Cleveland. It is quite possible that interest in these securities will be stimulated now that a larger number of brokers can handle deals without splitting commissions. If so, all concerned should benefit.

An obstacle to the expansion of dual trading is the lack of transfer facilities in the Chicago area for many of the dual issues. The NYSE requires that corporations designate an agent in New York authorized to transfer listed stocks from one holder to another. However, there is no restriction on providing duplicate facilities elsewhere. MSE officials are pushing for more Chicago transfer agents. If the stock must be transferred in New York, much of the advantage of dealing on the MSE is nullified. Not only is a transfer tax amounting to about four dollars per hundred shares exacted by the State of New York, but a delay of 10 days to three weeks (especially in odd lots) is encountered before stock certificates can be delivered. The delay is annoying to investors and expensive

for MSE specialists whose capital is tied up during the clearing process.

Large companies may find that the moderate cost (about \$1,000 per year) of additional transfer facilities with a Chicago bank or trust company would be money well-spent from the standpoint of stockholder relations. Part of the above-mentioned delay would be avoided if the stock were purchased at the NYSE and transferred here, but the transaction is much simpler if buying, selling, and transfer involves individuals close to home. Institutions which act as transfer agents for security issues in the Chicago area would obviously benefit from establishment of more dual transfer points, while those in New York would lose some revenue through lowered transfer activity there. The campaign for Chicago transfer facilities has already born fruit. A number of corporations have made arrangements or intend to do so in the near future.

#### OPPOSITION TO THE NEW EXCHANGE

The refusal of the Detroit and Cincinnati exchanges to join the merger was surprising considering that those casting ballots were representatives of brokerage firms, the group which benefits most directly from consolidation. Volume on these exchanges more than equaled that of the Cleveland, St. Louis, and Minneapolis-St. Paul exchanges during 1949. Since the balloting was close, it is possible that they may yet be persuaded to enter the consolidation.

One reason for opposition to the liquidation of local exchanges is simply local pride. Some of the exchanges in question have been in operation for 50 years or more, as long as the Chicago Exchange. Local civic and business groups like to point with pride to the local stock exchange. In the case of Detroit rejection of the merger was based partly on the belief that unlisted local issues with public distribution provided a better base for expansion of the exchange than is true in other cities.

Some brokers who have seats on the New York Stock Exchange have opposed the MSE on the reasoning that it would "dilute the value" of their seats in the East. They believe that some of the commissions they earn on "big board" stocks would be lost if other brokers in the same city could buy these issues on the Midwest Exchange. They are not easily convinced that increased market activity would be an offsetting benefit to the whole securities industry.

Another group which has opposed the merger are local transfer agents in some of the cities concerned. They feel that this type of income would be lost to them through appointment of Chicago transfer agents. These fears have been allayed by statements of Midwest Exchange officials that such was not the case.

There has been no open antagonism to the new venture, and in fact, the president of the NYSE has spoken favorably of the MSE if it does not dilute the New York market. However, certain financial observers in the East are apprehensive lest proponents of the MSE eventually look beyond their present objectives to the development of a new national market.

# Fiscal Prospects for State Governments

## Record Spending in Current Biennium Expected to Exceed Revenues

During the fiscal years 1950 and 1951, if present spending plans are carried out and revenue estimates prove to be accurate, Seventh District states will find it necessary to draw to such an extent upon surpluses accumulated during the boom years of the war and immediate postwar that reserves will be at dangerously low levels. Legislatures in many states, including all five District states, marked their 1949 sessions by authorizing expenditures greater than those for any previous years. Realized and anticipated declines in state revenues comprise the other facet of the fiscal picture. At the end of the current biennium many states will be in positions of precarious balance. Balances in state funds whose resources are unrestricted as to use are expected to be especially low. Even if economic conditions, with their immediate effect on tax collections and expenditures needs, develop as anticipated, 1951 legislatures will be faced with difficult fiscal problems.

### INCREASES IN EXPENDITURES

Despite the apparent ending of the inflation, 1949 legislatures had to contend with expenditure requests considerably in excess of those presented for the 1947-49 biennium (July 1, 1947 to June 30, 1949). The accompanying table indicates some of the changes in appropriations approved by legislatures in District states. In part this increase reflected the fact that, throughout the postwar boom, legislative provision for the cost of state and local government had lagged behind increases in price levels. During the 18-month interval between the adjournment of most 1947 legislative sessions and the convening of the 1949 sessions, the price indexes increased seven to

eight per cent; appropriations for 1950 and 1951 reflect these higher price levels.

Several other factors have been of importance in raising expenditures. Large amounts of needed construction and major maintenance work—for highways and state educational, health, and welfare institutions—have been deferred by wartime and postwar shortages of building materials and labor, and by rapidly rising costs. Increased institutional populations, higher education enrollments, and motor vehicle registrations have led the states to conclude that many of these improvements can no longer be postponed. This conclusion has been strengthened by the prospect of stable, or even slightly declining, construction costs.

Secondly, in recent years local governments have been successful in efforts to shift increasing shares of the greatly expanded costs of the major local functions to the states. Third, conventional standards for government services have been raised noticeably; an example of this is the widespread removal or raising of ceilings on maximum payments to recipients of public assistance. A fourth factor is the anticipation of somewhat higher levels of unemployment during the current biennium, and therefore higher public assistance costs.

### THE REVENUE PICTURE

Most states expect revenues during 1950 and 1951 to decline somewhat from the fiscal 1949 peak. It is expected, as the bases for the revenue estimates, that production, income, and employment will be somewhat below the high points in the fourth quarter of 1948. There are, however, wide variations among the states as to the ex-

**APPROPRIATIONS FROM STATE SOURCES FOR SELECTED PROGRAMS<sup>1</sup>**  
**SEVENTH DISTRICT STATES, TWO YEAR PERIODS ENDING**  
**JUNE 30, 1949 AND JUNE 30, 1951**  
(In millions of dollars)

Program	Illinois		Indiana		Iowa		Michigan		Wisconsin	
	1949	1951	1949	1951	1949	1951	1949	1951*	1949	1951
Operation of state institutions: total.....	173.1	189.1	45.8	62.1	38.0	48.6	113.8	140.0	45.6	57.8
Public welfare <sup>2</sup> .....	98.3	100.3	22.2	29.2	15.0	17.3	70.0	85.3	17.3	22.7
Higher education <sup>3</sup> .....	74.8	88.8	23.6	32.9	23.0	31.3	43.8	54.7	28.3	35.1
Public assistance programs.....	101.6	107.3	19.8	23.0	25.6	30.4	70.2	76.5	21.8	26.0
Aids to local government <sup>4</sup> .....	270.4	307.6	139.0	178.1	71.6	94.2	435.2	481.0	211.4	222.4
Construction, other than highway <sup>5</sup> .....	80.5	106.1	25.7	25.3	9.3	12.1	23.6	26.9	1.6	26.6
General operation <sup>6</sup> .....	140.8	156.6	52.0	62.9	34.0	37.0	119.5	128.4	33.1	38.0

<sup>1</sup>Excludes Federal grants expended by state agencies.

<sup>2</sup>Includes cost of operating penal and correctional institutions.

<sup>3</sup>Data for Illinois include disbursements from income funds consisting primarily of student fees.

<sup>4</sup>Includes shared taxes.

<sup>5</sup>Differences in the treatment of expenditures for such items as major repairs and improvements to existing structures in state financial reports prevent the data from being strictly comparable.

<sup>6</sup>Consists of outlays for the ordinary expenses of governmental departments and agencies. The data are not strictly comparable for all states; operating expendi-

tures from earmarked funds in some states are not specifically appropriated by the legislatures and are here estimated from various sources.

\*Michigan appropriations for fiscal 1950 are repeated for fiscal 1951 to arrive at biennial figures.

SOURCES: Illinois: *Annual Report of the Department of Finance, The Illinois State Budget* (biennial). Text of Appropriations Regular Session 60th General Assembly (biennial). Indiana: *State of Indiana Budget Report* (biennial). Laws of the State of Indiana (biennial). Iowa: *Iowa State Budget* (biennial), and Office of the Comptroller. Michigan: *State of Michigan Budget, and Statement of Legislative Appropriations*. Wisconsin: *Wisconsin State Budget* (biennial), *Wisconsin Session Laws* (biennial), and Office of the State Department of Budget and Accounts.



tent of the anticipated decline. Of the Seventh District states, Illinois, Iowa, and Michigan appear to anticipate economic conditions and revenues very close to 1949 levels. Illinois forecasts a decline of less than one-half of one per cent in General Revenue Fund receipts from the 1947-49 biennium to the current one. Iowa's General Revenue Fund appropriable receipts are estimated at about four per cent below those for 1949, and general purpose General Fund revenues for Michigan are expected to decline about .7 per cent. The Indiana budget anticipates successive declines of more than 10 per cent in 1950 and 1951 in non-earmarked revenues. Significant declines are expected in Wisconsin, based on anticipated declines in the State's major tax, the net income tax.

The above estimates are those contained in the budget documents of the respective states, and for the most part reflect expectations prevailing during November and December of 1948. New tax legislation enacted by 1949 legislatures is, of course, not taken into account; this includes the increase in the income and cigarette taxes in Wisconsin, and the increased gross income tax rates in Indiana to finance the bonus. Proposed tax increases were major issues in Illinois and Michigan, but the legislatures did not provide for material increases in revenues. In general, revenues of other operating funds follow the trends in non-earmarked receipts in the District states; however, since the area of legislative attention in the expenditure of public moneys is usually confined to the general fund, or a portion of it, because of constitutional or statutory proviso, the earmarked funds are not very significant for budget policy.

The probability of expenditures in excess of revenues presents serious problems to governments possessing little or no power to borrow to meet operating deficits. Such is the case with most Midwestern states, including the District states. The usual solution, and one that will be widely employed in the immediate future, is to draw upon balances accumulated during years in which receipts were superadequate. The war and postwar period was one of exceptionally large surpluses for most states, with expenditures increasing at a slower rate than revenues. Now that this lag has been overcome, the surpluses will provide the needed fiscal resources.

However, the widespread practice of earmarking certain choice sources of revenue for particular uses limits the availability of the accumulated balances for meeting current deficits in general governmental operations. Highway-user taxes are almost universally segregated for road purposes; substantial portions of the tax receipts in Michigan and Wisconsin, among District states, are earmarked for aids to local governments. A fairly large portion of total balances in recent years has been in highway or other construction funds. In many states, balances available for general purposes at the end of fiscal 1949 equaled less than six months' expenditures at the projected rate.

Operating deficits are expected to reduce general fund balances to negligible proportions by the end of 1951 in most District states. Unlike the 1949 legislatures which had these balances to draw upon, the 1951 session

may be forced to raise taxes and cut expenditures drastically. To provide additional cushioning for the states' finances during 1950 and 1951, administrative limitations on the rate of expenditures may be forthcoming. Illinois has in effect an administrative order limiting the operating expenditures of state departments in each year of the biennium to 45 per cent of the total appropriation. Both in Illinois and elsewhere, executive authorization for construction expenditures may be expected to be withheld as balances decline, especially if receipts do not measure up to expectations.

#### LEGISLATIVE ISSUES IN 1949

Fiscal issues which were almost universally discussed by state legislatures include requested higher appropriations for operating costs and for construction at state institutions, including state universities and colleges; proposed tax increases; changes in highway finances; and state aids to local governments, particularly for schools.<sup>1</sup> Other important questions which received somewhat less widespread consideration include bonuses for veterans, higher salaries for state employees, and public housing proposals. Considering the high mortality rate for fiscal proposals, a large number of changes were enacted.

#### ILLINOIS

In Illinois, the issues which received the most attention included state aid proposals and tax legislation. The General Assembly enacted legislation providing for a 35 million dollar increase in distributions to local school districts during the current biennium, an increase of 54 per cent over the amount appropriated for the previous biennium. A proposed 34 million dollar aid program for municipalities failed of passage after much discussion, because the revenue measures to finance it were defeated.

An estate tax was enacted to absorb the 80 per cent credit allowed under the Federal Estate Tax Act, and harness racing taxes and motor vehicle operators' license fees were increased. No other tax increases were enacted, although one of the major controversies of the session concerned unsuccessful proposals to broaden the coverage of the sales tax (retailers' occupational tax) by enacting occupational taxes on certain services. The proposal was expected to produce about 25 million dollars of additional revenue annually; its failure to pass resulted in the scaling down of common school aids from the Budget figure of 112 million dollars to 100 million and defeat of the proposed city aid program.

Another major issue in Illinois was the suggested increase in the gasoline tax from three to five cents per gallon, with changes in the distribution of its proceeds. The need for additional funds for state highway construction was instrumental in the proposal, and the various suggested patterns for distribution of the tax money raised the State's share above that existing currently—one-third each for the State, the counties, and

<sup>1</sup> For further details on aids and other developments in 1949, see "State Aids to Local Government" in the October 1949 issue of *Business Conditions*.



the cities. The point of controversy which defeated the tax increase was the demand for a share in the tax proceeds on the part of the townships. This sharing was designed to compensate for the often-recommended discontinuance of the program of aid for township roads from general revenues which was in effect during fiscal 1946-49. However, recent comments indicate that the issue will be an important one during the 1951 session.

#### INDIANA

Probably the most important fiscal decision made by the Indiana General Assembly concerned the method of financing the 150 million dollar veterans' bonus approved by the voters in the November 1948 election. Despite the fact that only 12 per cent of the voters indicated their preference for an increase in gross income tax rates and that three out of the four remaining alternatives received higher votes, the General Assembly chose the former method. The tax rates on wholesalers and manufacturers were increased 100 per cent, and those on all other income were increased 25 per cent. Constitutional provisions prevented recourse to bond financing. Another important piece of tax legislation was that increasing motor vehicle registration fees by two dollars for all classes of motor vehicles.

In the sphere of state-local relations, certain changes were made. The cigarette tax, which had previously been earmarked for either highway purposes or postwar construction (the choice was the Governor's), was made a general purpose revenue. The tax had provided five million dollars in fiscal 1949 for local roads and streets. At the same time, efforts to permit cities to levy property taxes to provide additional funds for road and street construction were defeated. School aids were expanded very greatly by the 1949 legislature; the estimated increase is nearly 45 per cent.

#### IOWA

Similar issues occupied the Fifty-Second General Assembly in Iowa. It provided for use of 50 million dollars of the balance in the General Fund (about half the total) to pay bonus claims processed during the current biennium, leaving the problem of financing the estimated additional 35 millions to the 1951 legislature. In general, the tax rates obtaining during the previous biennium were retained; the Governor's proposal to exempt food from the sales tax was rejected. The problem of highway finances was attacked along the lines which had been suggested by an interim legislative committee. A new Road Use Tax Fund was created, into which are to be deposited all collections from highway-user taxes, including newly-enacted higher motor vehicle registration fees. An estimated 8.5 million dollars per year of sales and use tax receipts is to be diverted into the road fund, which is to provide funds both for state highway construction and increased aids to local governments for local roads and streets. School aids also were increased; the magnitude of the increase, 85 per cent, is greater

than in most states which enacted increases in 1949.

#### MICHIGAN

Despite indications that the expenditures will exceed revenues during the 1950 fiscal year, the Michigan Legislature failed to enact any of the proposed legislation providing additional revenue. The two major tax proposals which were discussed were the Governor's recommendation for a 65 million dollar tax on corporation profits and the suggested three per cent tax on used-car title transfers, which was expected to produce 20 million dollars annually. Several other important proposed changes failed to pass. An attempt to modify the distribution of sales tax receipts by amending Article X, Section 23 of the State Constitution, which in effect earmarks almost 40 per cent of the state revenues for aids to school districts and local governments, was defeated. The amendment was adopted at the 1946 general election, and an effort to repeal it at the 1948 election failed. An effort to increase state revenues by reducing the amounts earmarked for the local units also was beaten; this was a proposal to eliminate the sharing of the receipts of certain state taxes, largely taxes on public utilities, with the localities. The recurring proposal to increase the gasoline tax from three to five cents per gallon was again defeated.

#### WISCONSIN

The nine-month session of the 1949 Legislature in Wisconsin made important changes in both expenditure programs and tax levels. School aids were increased by ten million dollars from the levels of the previous biennium, with the adoption of new aid formulae. This represents a thirty per cent increase. A long-deferred building program for state educational and welfare institutions was authorized by the Legislature, and substantial funds were provided. In addition to reappropriations amounting to nearly nine million dollars and old balances still expendable of 11.9 million, more than 17 million dollars of new money was provided. The total amount available for new construction during 1950 and 1951, is thus in excess of 38 million dollars. Part of this money will come from the newly-created State Building Fund, a long-range building reserve fund designed to finance future construction needs, into which 1.8 million dollars will be deposited each year.

A large veterans' housing program was set up by the Legislature to provide loans to individual veterans and grants to local housing authorities. About 16.4 million dollars are expected to be available for this purpose during the biennium. This amount represents previous and anticipated collections of the additional one dollar per gallon liquor tax enacted by the 1947 Legislature which was earmarked for this purpose. The major tax increases include a 25 per cent surtax on individual incomes, estimated to produce about seven million dollars annually, and a one-cent increase in the cigarette tax, expected to yield an additional 3.1 million per year.

## CONSUMER SPENDING CONTINUES HEAVY

(Continued from Inside Front Cover)

It appears that the basic underlying forces in consumer demand are downward, however, and that a real merchandising effort will be required of businessmen if consumer purchases in 1950 are to equal those of 1949.

### INCOME-SPENDING RELATIONSHIPS

Except for the rather narrow but important margin within which, primarily, decisions to save affect the rate of spending, the magnitude of total consumer expenditures is determined directly by the level of personal income. It is estimated that total retail sales in Seventh District states during 1947, 1948, and 1949 fluctuated only slightly, around 63 per cent of personal income receipts. This small variation (about one per cent) reflects not only changes in the rate of saving, but also fluctuations in the rates of tax payments and service expenditures. Although these factors undoubtedly offset each other to a considerable extent, it is clear that the relationship between income and retail sales is a close one.

Furthermore, large changes in the level of income receipts are likely to affect the relationship between spending and saving directly. Ordinarily, if incomes increase substantially, consumers will not increase their spending proportionately, but will elect to increase the proportion of their income allocated to saving. Conversely, if income receipts decline markedly, consumers will tend to increase the proportion spent, since a growing number of marginal spenders will reach the point where their incomes cover only outlays for necessities, and where saving becomes impossible.

Income payments in the Seventh District states during the four postwar years have averaged nearly three times the 1939 level (see Chart 1). From a total of about 31 billion dollars in 1946, income payments (before taxes) increased rapidly through 1948, totaling about 38.5 billion dollars in that year, as compared with 13 billion dollars in the prewar year.

Income payments in the District, however, appear to have declined somewhat during 1949. Total receipts for the first nine months of the year were estimated to be at the annual rate of about 38 billion dollars, or one per cent under the average 1948 rate. Almost all of the decline was caused by at least a 10 per cent decrease in proprietors' income, reflecting the substantial drops in prices of agricultural products (especially livestock) and to some extent the narrowing of profit margins of merchants.

### RETAIL SALES TRENDS

Sales of consumers goods at the retail level increased rapidly from 1946 through 1948, but at a gradually slackening rate (see Chart 1). Seventh District retail sales in 1946 totaled an estimated 18.2 billion dollars, increased to about 21.7 billion dollars in 1947, and reached a postwar peak of 24.6 billion dollars in 1948. Dollar volume declined somewhat during 1949, however, and

for the first nine months is estimated to have been at an annual rate of about 24 billion dollars.

As might be expected, consumer demand for many goods had been easing for some time before retail sales actually began to turn downward early in 1949. Sales tax collections in Illinois and Michigan indicate that the rate of increase in retail sales had been slackening gradually through all 1948. First-quarter sales were 19 per cent above 1947, second-quarter sales were only 14 per cent greater, and third- and fourth-quarter sales were only 10 and 9 per cent above the comparable three-month periods of 1947, respectively. Total dollar volume during each of the first three quarters of 1949 was somewhat lower than during 1948, but the rate of decline was much more moderate than a year earlier.

**Durable Goods**—During 1949, total sales of consumers durable goods remained at levels equal to or higher than those of 1948. Maintenance of this high level, however, resulted almost exclusively from the increases in sales of new automobiles, with most other durable lines registering losses from 1948 sales levels.

Seventh District registrations of new passenger cars during the first nine months of the year were about 35 per cent above the comparable period of 1948, despite a relatively low level of sales during January and February. Sales of used cars, however, are reported to have been at a lower rate and at considerably reduced prices from last year's levels. As a result, total sales of the automotive group of retail firms (including new and used car dealers, farm implement and car accessory retailers, garages and filling stations) in Illinois and Michigan during the first nine months of 1949 were only about eight per cent greater than in 1948.

Seventh District department store sales of housefurnishings and household textiles dropped off significantly from the high levels of 1947 and 1948 during 1949. Although sales of radio and television sets through the first nine months averaged about 25 per cent above 1948, sales of furniture, floor coverings, and particularly appliances displayed considerable weakness, especially during the spring and summer months. The dollar volume of sales in these lines increased sharply in the last months of 1949, but this recovery apparently was caused primarily by bargain and clearance sales and significantly eased credit terms. The weakness in consumer demand for housefurnishings and appliances, evidenced by these promotional efforts of merchants, may lead to a reasserted decline in sales during 1950, as the initial bolstering effects of eased credit terms wear off.

**Nondurable Goods**—Sales of nondurable goods typically fluctuate less widely than do those of durable goods. This is true at virtually all times, including the postwar period, because a large portion of nondurables consists of necessities and convenience goods, which have a relatively fixed place in most family budgets. Purchases of these goods can be reduced or put off, but not to the same extent as can the purchase of a house, car, home appliance, or major piece of furniture.

Dollar sales of the food and beverage class of retail stores provide a good example of nondurable goods sales



stability. Total sales of this class of stores in Michigan and Illinois amounted to about 4.6 billion dollars in 1947; in 1948, volume almost reached five billion dollars, an increase of somewhat more than eight per cent. During the same period the national index of retail food prices increased by about the same amount. Thus, it appears that the aggregate physical volume of goods sold in this class changed very little during these two years.

During the first nine months of 1949, however, total sales of foods and beverages in Illinois and Michigan increased slightly in the face of a decline in prices averaging four per cent. Thus, it appears that consumers are now buying either somewhat larger quantities or better qualities of foods. Food prices currently have been averaging five to six per cent below the peak experienced during the early fall months of 1948. Since prices of many foods are approaching or have reached the floors established by the Federal farm price support program, they are not expected to decline as sharply as during the past year. Since the physical volume of food and beverage sales has increased moderately, offsetting price declines to a large extent, total dollar sales volume at the retail level is not expected to weaken significantly during the coming months.

Seventh District department store sales of apparel last year declined substantially from 1948 levels. During the first nine months, sales averaged about six per cent below those of the comparable months of 1948. After gaining more than seasonally in August, dollar volume declined again in September and October. For the year as a whole, dollar sales probably totaled six to eight per cent under those of 1948, and somewhat below those of 1947. It is estimated that apparel prices averaged three to four per cent lower than in 1948, however, and therefore, it appears that physical volume sales during 1949 declined only moderately from those of 1948.

Total sales of Seventh District department stores averaged about six per cent below the comparable period of 1948 during the first nine months of last year. Sales tended persistently downward from an Easter high in April, reaching a postwar low 15 per cent below 1948 in July. Dollar volume increased markedly in August and September, reaching a level only three per cent below 1948 in the latter month. Due largely to work stoppages and unseasonably warm weather, and to a reassertion of a normal seasonal fall slump witnessed for the first time in postwar years, sales declined markedly in October. Dollar volume increased in November to a point only about six per cent below November of 1948, and preliminary information indicates that December sales about equaled those of 1948. Total dollar volume for all of 1949 is estimated to have reached a level about five per cent below that experienced during 1948. Since small price declines have occurred in most lines carried, the physical volume of sales for 1949 probably has been only moderately below the 1948 level.

#### SPENDING VERSUS SAVING

The absolute level of personal income and the nature

of expectations as to the immediate future are the primary determinants of the proportion of income which consumers will spend or save. Generally speaking, the better consumers believe their financial position is and the more optimistic they are concerning the future, given relative stability of income receipts at a high level, the larger will be the portion of their current income that they will spend.

The latest *Survey of Consumer Finances* by the Board of Governors of the Federal Reserve System, conducted in July 1949, indicated some major aspects of the current attitudes of consumers. First, approximately six out of every ten spending units felt that times had worsened during the first half of 1949. Second, about half of all respondents anticipated further moderate price declines during the rest of the year. Third, 60 per cent of those interviewed thought that it would be difficult or impossible to find other jobs at equal pay if they lost their present positions during the next few months. Fourth, more spending units were uncertain as to whether they would be earning more or less or about the same amount of money during the rest of the year, and about 35 per cent of those interviewed reported that they actually were making less money than a year earlier.

Consumers generally displayed a considerable amount of buying caution during the first part of last year. For the first few months of 1949, incomes remained close to 1948 peak levels, while consumers cut back expenditures somewhat. New institutionalized savings in the Seventh District increased substantially from 1948 levels, and at the same time consumer credit halted momentarily in its rapid postwar rise. During the summer months, however, effects of reduced incomes were felt to a greater extent. New savings of individuals, though continuing at a higher rate than during 1948, declined more than seasonally from first-quarter 1949 levels, and consumer credit resumed its earlier rise.

During the third quarter of this year, personal savings, as measured by the Department of Commerce, fell moderately below 1948 levels. In the Seventh District, institutionalized savings continued to rise, but consumer credit increased sharply, at least partly in response to eased credit terms occurring after expiration of Regulation W at the end of June. Mortgage and instalment sales credit on automobiles continued to rise rapidly, as residential building activity and sales of new cars remained at very high levels. Indications are that this increasing trend in consumer indebtedness continued unchecked during the last quarter.

Payment of the GI insurance dividend during the first half of 1950 should result in a substantial increase in savings, and may be reflected in a slackening in the rate of expansion in consumer indebtedness as well. Furthermore, the rate of new saving shows no indications of dropping to the relatively low levels witnessed during 1947 and early 1948. It may even increase moderately if consumer expectations regarding income, continued employment, and prices again weaken, given continued high income. If a sharp drop in income occurs, both spending and saving will contract—the latter at a greater rate.

**SEVENTH FEDERAL**



**RESERVE DISTRICT**



